The proposed CPA process is modeled after the New Jersey auction process designed, in large part, by Dr. LaCasse, who is expected to act as the independent Auction Manager. All BGS products will be auctioned off concurrently through the proposed "multi-round, descending clock auction", which is recognized as a highly transparent and efficient competitive procurement process that will best be able to address market structure and other procurement-related concerns. Dr. LaCasse's testimony and that of Mr. Blessing discuss product definition and auction design in more detail.

Under the filed procurement process, the Ameren Companies will solicit bids for individual load shares (or "tranches") of full-requirements wholesale electric power supply for each of the three BGS groups to meet the combined regulated service load of the Ameren Companies. Full requirements service means that each supplier is physically responsible for all of the capacity and energy necessary for each of the Ameren Companies to perform its responsibilities as a MISO load serving entity ("LSE") for its regulated retail service customers, and. In addition, each supplier will also be financially responsible for its proportionate share of the ancillary services necessary to serve its portion of the BGS load.[11]. The Ameren Companies will procure network integration transmission ("NITS") service and ancillary services from the MISO. Suppliers only need to arrange transmission services to deliver their supply to the Ameren Companies' control areas.

[11] Ameren will procure the ancillary services but will be reimbursed by the suppliers.

To promote a large set of qualified suppliers, each tranche of BGS supply, defined as a fixed percentage of the procurement group's BGS load, is sized to be only approximately 100 MW of peak load. Once bids are awarded, each supplier would be obligated to supply that fixed percentage of the Ameren Companies' combined retail load at all times regardless of the actual magnitude of the load. This also means that qualified BGS suppliers, not the distribution companies, take on price and volume risks (e.g., customer switching risks) as well as the day-to-day responsibility for resource procurement and portfolio/risk management.

Q. Why do the Ameren Companies propose to combine their power procurement?

A. A combined procurement process for all three Companies is consistent with a wholesale market structure in central/southern Illinois that is reasonably homogenous across the heavily-intertwined service areas of the Ameren Companies. A single procurement process will be able to take advantage of MISO's Illinois trading hub and is also expected to result in greater supply diversity, reduce the relative market shares of individual local generators (e.g., Dynegy and Ameren Corp.'s own generation affiliate), streamline and thus increase the competitiveness of the bidding process, and reduce implementation and ongoing administrative costs.

Q. Why do the Ameren Companies propose to remain LSEs for BGS service?

A. Although most of their obligations as a MISO LSE would be passed on to BGS suppliers through the BGS Supplier Forward Contracts, the Ameren Companies propose that they remain the LSE for two reasons. First, it clarifies that the

Companies remain the providers of last resort for their regulated service customers, which will require the Ameren Companies to supplement and replace BGS supplies in contingency situations such as supplier default. Second, the designation of the distribution company as the LSE also makes clear that the transaction between the BGS supplier and the distribution companies is a wholesale contract, and that the BGS supplier will not be deemed a supplier at retail under Illinois law, which could discourage suppliers from bidding in the auction.

Q. Does the procurement process contain any safeguards and additional measures to protect customers, assure a competitive outcome, and maintain reliability?

A. Yes. The proposed competitive procurement process contains a number of provisions to protect customers, assure a competitive outcome, and maintain reliability.

First, the competitive auction would be monitored by the Commission through its Staff and an independent Auction Monitor. This will ensure a transparent, unbiased bidding process and, like in other states that employ similar approaches, allow for prompt review and confirmation of the auction results by the Commission. We also propose additional safeguards to alleviate concerns over affiliate participation. The Ameren Companies' affiliates would be permitted to participate in the proposed third-party-monitored procurement process subject to additional safeguards: (1) distribution company employees will not be able to participate in the preparation of a bid; and (2) employees from

467 generation or marketing affiliates will not be able to participate in the
468 administration of the procurement process. All existing affiliate transactions and
469 standards of conduct rules will also continue to apply.

470 Second, the BGS procurement will benefit from MISO resource adequacy
471 standards and market mitigation. For example, MISO's mitigation of spot
472 markets will provide a clear constraint on the pricing of any longer-term supply
473 contracts, including BGS contracts. Due to buyers' and marketers' ability to
474 hedge spot market volatility and arbitrage average price differences between
475 forward and spot purchases, a generator would not be able to sell longer-term
476 bilateral contracts at a price above the (risk adjusted) expected future spot market
477 prices. MISO's market monitoring efforts and automated mitigation procedures
478 to directly address suppliers' ability to exercise market power in spot markets will
479 thus also mitigate purchases under the BGS auction's longer-term contracts. In
480 addition, MISO resource adequacy standards will ensure that sufficient capacity is
481 dedicated to achieve reliable service.

482 Third, the auction process itself contains a number safeguards, including: a
483 requirement for suppliers to provide indicative offers; scaling of the procurement
484 process to avoid bid insufficiency; contingency procurement provisions under
485 which energy can be purchased through power purchase agreements, for limited
486 periods, directly from MISO spot markets; and load caps under which no more
487 than 50% of the Ameren Companies' combined fixed-priced BGS products and
488 no more than 50% of Ameren Companies' BGS-LRTP product can be awarded to

a single bidder in a given auction. As Dr. LaCasse explains further in her testimony, similar safeguards have been employed successfully in New Jersey.

Fourth, the proposal also contains a number of measures to reduce supplier default risks. We will establish and maintain a website for communicating with bidders and for providing access to pertinent data to facilitate bidders' evaluation of their supply obligation (e.g., available historical loads, load research, and retail switching information for each BGS procurement group). This information will not only reduce bidders' costs of participating in the CPA, but will also reduce the risk of suppliers misjudging their supply obligations that, ultimately, could lead to supplier default. But, importantly, we propose to promote reliability and protect customers through explicit supplier prequalification and credit requirements, including:

- Signed confidentiality agreement;
- Qualification as MISO market participant in good standing;
- Any and all necessary authority to sell at the designated price;
- Provision of credit and financial information to allow assessment of creditworthiness and financial capability in accordance to pre-specified risk management criteria;
- A binding bid agreement and provision of bid assurance collateral; and
- After BGS supply contracts are awarded, posting of additional collateral is required based on mark-to-market accounting of the contract and the supplier's credit rating.

The procurement processes in New Jersey and Maryland provide detailed examples of similar pre-specified and commission-approved supplier

prequalification requirements that have resulted in the reliable, competitive supply of utilities' regulated service.

Q. How would the Ameren Companies procure power in the event that one of the BGS suppliers defaults?

A. To protect customers against (however unlikely) cases in which a supplier defaults on its obligation after bids have been awarded, we propose to replace the defaulted on contract using a pre-defined process. This process is described in detail in the direct testimony of Mr. James Blessing.

Q. Do the proposed procurement and retail rate proposals maintain Commission oversight?

A. Yes they do. Although our CPA proposal greatly streamlines the regulatory process, it would also maintain Commission oversight. Under our proposal, the Commission will: (1) approve the procurement methodology and process before the auction takes place; (2) closely monitor compliance with the approved procurement process with assistance of an independent Auction Advisor; (3) be able to initiate an investigation of the auction outcomes if the procurement was not conducted in compliance with the process; (4) approve the BGS rate structure for the Ameren Companies' and the rate allocation methodology used to translate the procurement costs into retail rates; (5) approve the market value adjustment factor; (6) approve the contingency plans that describe the process the Ameren Companies will use to purchase any BGS supply not obtained through the auction process and (7) approve any proposed prospective changes to the procurement process. Of course, the Commission also continues to have full regulatory

oversight over the Delivery Service ("DS") rates and the DS component of bundled service rates. The Commission will also fully retain its ability to implement potential future energy policy options, such as renewable resource standards or energy efficiency and low income programs.

Q. What is the process under which the Commission will approve supply contracts selected through the auction process?

A. If the Commission approves the proposed CPA, the auction will be conducted strictly in accordance with the auction rules. Under this process, the contracts awarded through the auction would be presumed prudent and their full costs would be recovered in rates as long as the procurement process was adhered to.

More specifically, the proposed Rider MV provides for prompt post-auction consideration of the auction results by the Commission. Only if the Commission concludes that grounds exist to initiate and investigation or complaint concerning the auction outcome, it would notify the Ameren Companies, trigging the pre-specified contingency provisions. In deciding whether to issue a notice of investigation or complaint, the Commission, in consultation with its Staff and the Auction Advisor, would consider if the competitive procurement has been conducted in accordance with the approved procurement process and whether there was unambiguous evidence that the auction outcome has been manipulated.

If no such action is taken by the Commission within three days following notice of the end of the auction from the Auction Manager, the auction-determined procurement costs should be deemed prudent for the purpose of full

cost recovery in retail rates. At that point, the Ameren Companies would proceed with the acquisition of supply from the pre-qualified successful bidders.

Q. Why is it important that the auction be deemed final so quickly after the auction closes?

A. Bidders will not accept an open-ended process. If bidders knew that the auction were subject to a lengthy post-auction review, they would either be less likely to bid, or would increase their asking price if they did bid, to reflect the greater risk to them. Power suppliers with capacity to sell seek certainty. As Mr. Pfeifenberger also explains in his testimony, the almost immediate approval of auction outcomes is also consistent with the approval process in other restructured states.

B. Structure and Determination of Post 2006 Retail Rates for Bundled Service

Q. How do the Ameren Companies propose to determine and structure retail rates for Post-2006 bundled service?

A. As explained in the testimony of Mr. Cooper, Ameren proposes to transition its bundled services to new tariffs that combine a BGS component with its current DS rates. These BGS and DS components are proposed to be "bundled" into a single tariff offering for regulated service similar to the current bundled tariff offerings. However, as recommended in Staff's Post- 2006 Report, the BGS and DS components of the bundled service offerings will be shown separately on customer bills to facilitate comparison of bundled service rates with unregulated retail service offered by alternative retail electric suppliers. The DS component of the Ameren Companies' post-2006 bundled service tariff would be based on the

distribution companies' applicable DS rates on file with the Commission and each of the current rate classes for bundled service would be assigned to the appropriate DS rate class.

Similar to the structure of DS rates, we propose to reduce the number of service rate classes with respect to the BGS rate component. As Mr. Cooper explains in more detail, the Ameren Companies would offer a fixed-priced retail rate structure option for each of the residential, small business, intermediate business, outdoor lighting and large business customer classes. As also explained in Mr. Cooper's testimony, the new BGS-based retail rate classes are proposed to be uniform across Ameren's distribution companies.

Q. How will the rates for bundled retail service be determined for individual rate classes within each auction procurement group?

A. We have developed for the Commission's approval the rate allocation formulas that would be used to translate the auction clearing price for BGS-FP, BGS-LFP, and BGS-LRTP into the filed rate structures of the bundled service tariffs. As explained in Mr. Cooper's testimony, these rate allocation formulas apportion the auction's market clearing prices to ratepayers according to their respective load factors and other load characteristics to reflect the different contributions of customers to procurement costs. As further explained, the rate allocation formulas also seasonally differentiate customer rates based on the pre-specified factors. In many respects the BGS rates are designed to consider a number of the same cost causation factors that are reflected in current bundled rates.

606 Under this process, we would submit to the Commission updated retail
607 charges determined with the Commission-approved rate allocation formulas
608 concurrently with the signing of BGS supply contracts. As explained in Mr.
609 Mill's testimony, in addition to rates determined directly from the auction
610 outcome, the BGS component also includes an "Adjustment Factor" to true up
611 expected small differences between BGS revenue collected from retail customers
612 and the total BGS procurement costs incurred by the distribution utilities.

613 *C. Cost Recovery*

614 **Q. How will the Ameren Companies recover the cost of procuring power for the**
615 **supply of BGS service?**

616 A. The total BGS-related costs recovered in rates would include: (1) the BGS supply
617 costs under the awarded BGS contracts); (2) labor, consulting and administrative
618 and general, capital and other costs related to power supply procurement and (3)
619 the additional costs, if any, that the Ameren Companies would incur if they had to
620 purchase supplemental BGS supplies as the result of certain contingency
621 provisions. Such contingency purchases would be required as a result of supplier
622 default or if sufficient resources could not be solicited through the auction. This
623 cost of contingency power purchases for BGS supply, if any, may include the
624 incremental costs of temporary purchases from MISO spot markets or the cost of
625 replacement power purchase agreements. Any contingency power supply costs
626 would be recovered through a separate charge to BGS customers, as explained by
627 Mr. Mill.

D. Consistency with State Energy Policy Initiatives

Q. Can the proposed CPA accommodate potential future Commission policies and/or legislative mandates on subject matters such as energy efficiency, low income, or renewable resource programs?

A. Yes. Any such energy policy objectives can easily be accommodated under our Post-2006 framework. In the case of potential future state-wide renewable resource standards, for example, distribution companies could simply integrate the resource standard into their BGS procurement process so that the renewable resource requirement becomes a wholesale portfolio management responsibility for all wholesale suppliers of BGS service. Energy efficiency programs could be implemented as a state-wide initiative that is funded through a non-bypassable surcharge on all energy delivered through all Illinois utilities. Similarly, low income programs could be implemented on a utility-wide basis through surcharges on all energy delivered over the company's distribution system (i.e., regardless of whether the service is provided by the utility or alternative retail providers). To the extent that the State or the Commission entertains policy initiatives such as renewable resource, low income, or energy efficiency programs, we strongly recommend that their design and implementation be state-wide in scope and be applied to all retail/wholesale suppliers operating in Illinois so that the burden of any such initiatives does not fall predominantly on the utilities' regulated service customers. Similarly, State and Commission policy (as they affect utility cost recovery and rate design) must ensure that RTO-related costs and compliance with RTO requirements do not become the primary

responsibility of the Illinois utilities and their regulated service customers, but are borne uniformly by all retail and wholesale suppliers. This applies, for example, to regional resource adequacy requirements.

IV. BENEFITS OF THE POST-2006 PROPOSAL

Q. What are the benefits you have identified in the selection and development of the proposed procurement approach?

A. Our proposed procurement process for the Companies' Post-2006 supply of regulated service provides a number of significant procurement-related benefits, maintains Commission oversight, promotes reliability, and protects customers. Compared to other procurement options, the proposed "vertical tranche" approach also offers a more transparent, less contentious process, provides a better allocation of risk, offers increased efficiency at predictable retail rates, and is the predominant approach used in other retail access states facing similar policy issues.

The procurement process meets the goals of restructuring legislation, is consistent with FERC affiliate sales policies, and, importantly, also satisfies the CILCO Commitment—namely that the Ameren Companies would use a competitive procurement process for their Post-2006 supply of regulated service load. As the Commission noted in its Final Post-2006 Initiative Report to Governor Blagojevich, "[a] competitive procurement process will deliver the most efficient pricing to customers over the long run."[12]

[12] Final Report of the Illinois Commerce Commission's Post 2006 Initiative To Governor Rod. R. Blagojevich and The Illinois General Assembly, p. 3.

Our proposal to bid out shares of full requirements service is exceptionally transparent because the procurement of standardized supply products (i.e., vertical tranches) allows for the full pre-specification and pre-approval of the procurement and evaluation process without the need to apply additional judgment or require additional negotiation during the bid selection process. This means all price, non-price, and bid evaluation issues can be fully resolved, specified, and approved prior to conducting the auction. The regulatory certainty, the transparency, full pre-specification, and small size of individual tranches also increase competition by promoting participation of a wide, diverse group of suppliers.

The vertical tranche method of bidding out shares of full requirements service efficiently utilizes the portfolio and risk management capabilities of experienced wholesale market participants and avoids duplication of active portfolio management functions within the regulated distribution companies. In other words, the approach allows the regulated distribution utilities to focus on what they do best (i.e., distribute power to end users) while allowing wholesale suppliers to focus on what they do best (i.e., take on all generation-related responsibilities, such as risk management and assembling and managing their least-cost resource portfolio) to supply power at the fixed contractual terms defined in the procurement process.

Our proposed procurement process results in market-based pricing while maintaining safety net service and protecting customers from undue wholesale market volatility. In particular, the proposed portfolio of overlapping three-year supply contracts provides stable rates for residential and small business

customers, while still sending price signals that adequately reflect current market prices. The annual fixed-price contracts for large customers also provide stable, market-based rates that can easily be compared with offers from other alternative retail electric suppliers. Market-based pricing that allows a straightforward comparison of choices for consumers further facilitates the development of retail competition.

The full pre-specification of the procurement process not only increases transparency, which is particularly important in the context of participation by affiliated suppliers, but it also results in a streamlined, less complex, less contentious regulatory process. At the same time, as I discussed in the prior section of my testimony, the process also maintains full Commission oversight and allows for the continued stakeholder input on improving the procurement process over time.

Our proposed CPA benefits customers by enhancing competition between wholesale suppliers to achieve the best possible price for the reliable supply of the utilities' remaining regulated service obligations. This proposal also promotes diversity of supply, reliability, and customer protection by: (1) allowing participation by a large, diverse set of wholesale suppliers; (2) imposing supplier pre-qualifications and credit quality requirements; and (3) explicitly specifying conditions and procedures to fill any supply shortfalls that may occur during the auction process or as a result of supplier defaults.

The proposed procurement process has an established track record in other restructured states. For example, as discussed further in the testimony of Mr.

Pfeifenberger, the approach to bid out vertical tranches of full requirements contracts has been prescribed as the default methodology for post-rate-freeze procurement of regulated retail service in Ohio and is already being used successfully to supply regulated generation service in other states that have undergone restructuring similar to that experienced in Illinois: New Jersey, Maryland, the District of Columbia, Rhode Island, Connecticut, Massachusetts, Maine, and Texas.

Finally, the proposed auction design has been used successfully in New Jersey for four years. Most recently, the auction format also was successfully used in Ohio as a means to verify that FirstEnergy's proposed affiliate supply contract did not exceed market prices. The FirstEnergy auction was able to solicit sufficient supplies despite an adverse environment marked by the facts that FirstEnergy itself did not bid any supplies into the auction, that the auction was held more than one year ahead of the contracts' delivery date, and that it was conducted before MISO implemented its "Day 2" energy markets and related market designs.

Q. What are the benefits of your proposal with respect to retail rate making?

A. Ameren's proposal streamlines retail ratemaking in several ways. First, it provides a clear pre-specified mechanism for translating the results of the procurement process into retail rates. This also reduces the uncertainty faced by wholesale suppliers as they will know at the time of the auction how the auction results will affect retail rates, which allows an assessment of how much load would likely switch to alternative retail suppliers. Second, by providing a fully

pre-specified Commission-approved process, bidders can be confident that the results of an approved auction process will be accepted. It provides further regulatory certainty in the form of full cost recovery to the utilities if they follow the Commission-approved procurement approach. Third, as discussed above, the proposed process also offers the benefit of full compatibility with future Commission policies and/or legislative mandates on subject matters such as energy efficiency, low income, or renewable resource programs.

Q. You mentioned the importance of stable, market-based rates for customers. Why are market-based retail rates desirable?

A. Post-2006 bundled rates that reflect the cost of purchasing power at competitive market prices are important for a number of reasons. Stable but market-based rates provide proper price signals that allow customers to make more efficient choices regarding their consumption of electricity, their investment in energy-intensive equipment, their selection of fuel for home heating applications, and their selection of service offerings alternative retail electric suppliers (e.g., green power options or innovative pricing plans). The latter is particularly important if the retail access and the creation of a level playing field for retail competitors continue to be a policy objective in Illinois.

Q. You explained earlier in your testimony that your proposed CPA was designed consistent with guidance received through the Commission's Post-2006 Initiative. Does the procurement process satisfy the 18 desireable characteristics identified by the Post-2006 Initiative's Procurement Working Group?

A. Yes, it does. As explained by Mr. Blessing, Ameren's procurement approach satisfies all eighteen desirable characteristics identified by the Procurement Working Group.

Q. Is the proposed CPA consistent with the recommendations that Commission Staff's made based on its participation in the Commission's Post-2006 Initiative?

A. Yes, based on various meetings with Staff and the December 2, 2004, Post-2006 Staff Report, I believe it is. As Staff noted in its Post-2006 Report:

- Staff believes that the vertical tranche auction "is expected to come the closest to possessing the majority of [the Procurement Working Group's] 18 desirable characteristics" which Staff has organized into five overarching policy goals. Staff also concludes that vertical tranche auctions "can best achieve these five overarching policy goals: mitigation of market structure problems; provision of regulatory certainty; provision of market based prices and rate stability; provision of a straightforward mechanism to convert supply acquisition costs into retail rates using traditional rate design, and provision of a working option by January 2007."[13]

- The vertical tranche auction, which "assures full transparency to all stakeholders,"[14] is Staff's "preferred procurement method" for large electric utilities, such as Ameren or ComEd, "that own little to no generation capacity (having spun off most or all of their generation assets)."[15]

- Staff finds that the vertical tranche auction approach would "best mitigate" identified affiliate and market power concerns, and "is expected to come the closest" of any procurement approaches to addressing the concerns of Staff and other parties.[16] Staff finds that "the transparency of the vertical tranche auction is its central strength" and that it "should result in as

[13] Post-2006 Staff Report, p. 3 (see also pp. 7 and 12).

[14] Post-2006 Staff Report, p. 9.

[15] Post-2006 Staff Report, p. 10.

[16] Post-2006 Staff Report, p. 10.

competitive and outcome as is possible given the underlying concentration of generation assets."[17]

- Staff further notes that "the transparency of the auction process also serves to reduce the risk of after-the-fact prudence review of individual contracts. The auction, rather than the utility, determines how much suppliers are paid and how much they supply toward meeting bundled load. This reduces the need to scrutinize utility decisions and potential favoritism toward affiliates. In addition, the use of a State-approved bidding process, such as a vertical tranche auction, addresses FERC requirements for arm's length transactions between utilities and their wholesale affiliates."[18]

- "Since the auction's structure and procedures would be vetted and approved by the Commission prior to the auction's actual execution, acceptance of the auction's final results should be fairly routine." As Staff notes, "if the auction is structured correctly, unreasonable prices are not possible, almost by definition."[19]

- The use of a vertical tranche auction is also consistent with one of the main policy goals, the transition to stable but market-based prices for utility-provided energy.[20] Staff recognizes that the procurement plans' "overlapping multi-year full requirements contracts with suppliers ... enables the utility to provide a market-based but significantly stable price for small customers."[21] Such market-based pricing of regulated service is important because "without appropriate price signals, customers may not be able to make well-informed strategic decisions regarding their long-term investments in energy-intensive equipment."[22] It is also important for creating a level playing field for alternative retail service providers in particular because "[m]arketers will find it easier to compete against contemporary market-based prices than [the existing] pre-1997 cost-based rates."[23]

- Staff stresses that "[a] vertical tranche auction poses no special problems for retail ratemaking. [The auction results] can be easily converted into electric rates for individual customer classes. Furthermore, ... renewable portfolio standards [as well as] the objectives of fuel diversity, demand response requirements, or programs designed to help low income

[17] Post-2006 Staff Report, p. 12.

[18] Post-2006 Staff Report, p. 14.

[19] Post-2006 Staff Report, pp. 13-14.

[20] Post-2006 Staff Report, p. 12.

[21] Post-2006 Staff Report, p. 15.

[22] Post-2006 Staff Report, p. 14.

[23] Post-2006 Staff Report, p. 33.

consumers pay their utility bills can be pursued within the context of an auction process.'[24]

- Staff further states that "[t]he transparency and liquidity of the markets made possible via regional ISOs will serve to provide, relative to more traditional markets found in the Midwest, a far greater number of resources that can be drawn upon to efficiently serve and support load. Providing a market where geographically diverse generators must compete on a daily basis to provide power to the grid reduces the relative importance of what might otherwise be local monopolies."[25]

- Finally, Staff notes that the auction process reflects the lessons learned from other states and is a solution that likely "could be in place before January 2007. Notably, New Jersey has been successful in implementing [such an] auction annually for the last three years. The results of the auction have been found to be reasonably competitive and acceptable by the New Jersey's Board of Public Utilities every year since the auction's inception. Other states are using the New Jersey auction as a blueprint for their own plans to obtain supply for bundled service."[26]

Q. Have the success and benefits of the New Jersey auction design also been recognized by those involved in New Jersey's procurement process?

A. Yes. The testimony of Dr. LaCasse, who managed the New Jersey auctions since their inception, discusses the success and benefits of this approach in greater detail. As she explains, the uniform-price and multi-round nature of the proposed auction format is broadly recognized to increase the efficiency of the procurement process and to determine market prices most reliably. As New Jersey Commissioner Frederick Butler specifically noted in his April 29, 2004 presentation at the Commission's Post-2006 Symposium, the advantage of New Jersey's multi-round, uniform-price auction format for basic generation service include:

[24] Post-2006 Staff Report, p. 15.

[25] Post-2006 Staff Report, p. 17.

[26] Post-2006 Staff Report, pp. 15-16.

- "Efficiency – BGS is supplied by the lowest-cost bidder;
- Lowest price – leads to lowest possible price for BGS supply;
- Market value – leads to BGS prices that reflect market forces;
- Proper risk sharing – risk is borne by those who can manage it at lowest costs;
- Transparency – leads to more aggressive bidding;
- Objective and fair – attracts more bidders and minimizes post-auction challenges."[27]

V. CONSISTENCY OF AMEREN'S PROCUREMENT PROPOSAL WITH FERC AFFILIATE TRANSACTION REQUIREMENTS

Q. First, before considering the FERC rules or protocol, is it important that the Companies' wholesale marketing affiliate be able to participate in the auction?

A. Yes, for following reasons. First, having more suppliers is good for customers. More suppliers mean more competition, and more competition means lower prices. Second, the utilities' affiliates may be more competitive in bidding. To deprive the affiliates of the right to participate can lead to higher prices than otherwise. This is so not only because the affiliates are not competing but other suppliers may change their ultimate bid price knowing the affiliates are not competing.

Q. Does the CPA retail rate proposal require the approval of the FERC?

A. FERC does not regulate retail electricity sales, so the Ameren Companies do not require the FERC's approval to implement its procurement and retail rate proposal. The Commission has exclusive jurisdiction over the retail prices

[27] Butler Presentation, p. 8.

charged to Illinois retail customers and therefore must approve how the prices resulting from the auction are translated into retail rates.

FERC, however, has exclusive jurisdiction over wholesale power sales, so any party awarded a supply contract through the proposed procurement process will require FERC approval before it can begin such sales. (Most, if not all, of the parties expected to participate in the procurement process, however, already have pre-authorization from FERC to sell power at market-based rates.) In addition, a long-term (one year or longer) wholesale power contract between the Ameren Companies and affiliated generation on wholesale marketing companies must meet certain guidelines and requirements to receive FERC approval.

Q. What is the significance of FERC's review of such inter-affiliate power sales agreements?

A. Given the nature of generation ownership in Illinois today, affiliates of the Illinois operating companies likely will supply part of the generation needed for post-2006 service regardless of the procurement method chosen. Failure to take account of FERC policies on inter-affiliate power sales agreements may result in FERC modifying or rejecting an inter-affiliate sales agreement entered into pursuant to the procurement process and force the Ameren Companies to "redo" the auction and/or buy power on the spot market. Such regulatory uncertainty is best avoided by designing the procurement process in a way that prevents any affiliate abuse, so as to alleviate any concerns FERC may have in the future.

Q. Do the affiliated generation and marketing companies plan to participate in the proposed auction for basic generation service by the Ameren Companies?

A. It is my understanding that AEM, which markets power for Ameren's generating companies, plans to participate in the auction to serve load in the service areas of Ameren's Illinois operating companies (i.e., AmerenCIPS, AmerenCILCO, and AmerenIP). It is also my understanding that, if ComEd holds an auction, and uncommitted generation resources are still available to AEM, AEM is also planning to participate in that auction as well.

Q. Why does the FERC have specific guidelines and requirements for purchase power agreements ("PPAs") between affiliated companies?

A. FERC is concerned about the potential for "self-dealing" when a utility purchases power from an unregulated affiliate. Such self-dealing potentially could harm both the utility's retail customers and wholesale competition. For example, when a utility purchases power from an affiliate not subject to cost-of-service regulation, the buyer may have an incentive to favor its affiliate even if the affiliate is not the least-cost supplier, because the higher profits (from the above-market purchase) would accrue to the seller's shareholders. FERC is concerned that purchasing power at an above-market price from an affiliate would not only harm the purchasing utility's retail customers (an issue which is under the exclusive jurisdiction of state regulatory commissions) but that such deals would also harm wholesale competition by reducing the market share of non-affiliate sellers and generally discouraging their entry into and participation in the wholesale market.

Q. What evidence is an applicant required to submit to FERC to demonstrate that a PPA with an affiliated company is not the result of self-dealing or other affiliate abuse?

A. The FERC's current standards for power sales between affiliates evolved from the guidelines established in its 1991 Edgar order.[28] In Edgar, the FERC held that, in analyzing market-based rate transactions between an affiliated buyer and seller, it must ensure that the buyer has chosen the lowest cost supplier from among the options presented, taking into account both price and non-price terms. The FERC set forth several ways for a utility to show that it did not unduly favor an affiliate. One type of evidence is "direct head-to-head competition between [the seller] and competing unaffiliated suppliers either in a formal solicitation or in an informal negotiation process."[29] Such evidence is reviewed by the FERC to ensure that: "(1) the solicitation or negotiation was designed and implemented without undue preference for the affiliate, (2) the analysis of the bids or responses did not favor the affiliate, particularly with respect to evaluation of nonprice factors, and (3) the affiliate was selected based on some reasonable combination of price and nonprice factors."[30]

If a competitive solicitation is not used, an affiliate sale can be justified on the basis of a "benchmark analysis".[31] A benchmark analysis compares the prices, terms, and other conditions of the affiliate power sale to other contemporaneous power sales of the same product in the same geographic market

[28] Boston Edison Co. Re: Edgar Electric Energy Co., 55 FERC ¶ 61,382 (1991) (Edgar)

[29] *Id.* at 61,168.

[30] *Id.*

and of a similar duration. A third type of evidence that an applicant could provide would be the prices that non-affiliated buyers were willing to pay for the similar services from the seller.[32]

Q. Over the past few years, has FERC extended the Edgar standards to additional transactions?

A. Yes. In the "Mountainview"[33] order issued February 25, 2004, FERC announced that it would extend the Edgar provisions to all long-term inter-affiliate PPAs, regardless of whether the agreements were at cost-based rates or market-based rates. FERC reasoned that doing so will not only "protect wholesale power customers," but also will identify and combat affiliate preferences that "could discourage non-affiliates from adding supply in the local area, harming wholesale competition."[34]

On July 29, 2004, in an order approving the sale of two generating facilities from AEG to AmerenUE, FERC stated that it would, in the future, also apply the Edgar standards to intra-corporate asset transfers.[35] Thus, the sale of a generating facility from a merchant entity to its affiliated load-serving utility now must meet the Edgar standards to demonstrate the absence of affiliate abuse.

Q. Has FERC recently modified or clarified any other aspect of the Edgar standards?

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31 *Id.* at 62,169.

32 Id.

33 Southern California Edison Co. on behalf of Mountainview Power Co., LLC, 106 FERC ¶ 61,183 (2004).

34 Id. at PP 58-59.

35 Ameren Energy Generating Co., 108 FERC ¶ 61,081 (2004) (*Ameren*).

A. FERC has not modified the Edgar standards but recently provided additional guidance on the kind of competitive solicitation process that would enable an applicant to satisfy the Edgar standards. According to FERC, a competitive solicitation process needs to adhere to four principles:

(1) Transparency: the competition should be open and fair;

(2) Definition: the product or products sought through the competitive solicitation should be precisely defined;

(3) Evaluation: evaluation criteria should be standardized and applied equally to all bids and bidders; and

(4) Oversight: an independent third party should design the solicitation, administer bidding, and evaluate bids prior to the company's selection.[36]

FERC explained that the transparency and oversight principles apply to all aspects of the competitive solicitation whereas the definition principle applies in the design of the solicitation and the evaluation principle applies as bids are evaluated.[37]

Q. Does your procurement proposal meet the four principles that FERC has established for competitive solicitations?

A. Yes. The proposed procurement process clearly meets each of the four principles set forth by FERC. The procurement process will be highly transparent; the products sought will be precisely defined; pre-specified standardized evaluation

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[36] See Allegheny Energy Supply Company, LLC, 108 FERC ¶ 61,081 at P 22 (2004) (Allegheny).

[37] Ameren at P71.

criteria will be used to select bidders and bids; and an independent party designed the solicitation, will administer the auction, and evaluate and select the bids.

With respect to transparency, all relevant information about the auction will be made available on a publicly viewable website managed by the independent Auction Manager. This website will contain the prequalification requirements, detailed auction and bid selection rules, the supplier contracts, and all other information necessary for bidders to participate effectively. In addition, the Auction Manager will hold bidder information sessions open to any interested party.

With respect to clear product definition, all bidders will be competing for a fully standardized product—a vertical "slice" or "tranche" of Ameren's retail load. The Supplier Forward Contracts will spell out in detail the product terms and conditions for all potential bidders. The use of standard contracts allows any potential bidder to compete on a level playing field with any other bidder.

The proposed solicitation will fulfill FERC's third guiding principle, standardized evaluation. The auction will reveal a clear, unambiguous price for each product. Winners will be selected under the auction rules based on price alone because all bidders will be supplying the product under the same non-price terms. In addition, the auction provides for a pre-auction bidder qualification process to assure that all potential bidders meet certain stipulated minimum requirements. Finally, the auction process itself means that no post-bid negotiation will take place, which further ensures fair and equal treatment of all bidders.

Finally, the proposed solicitation will also comply with FERC's fourth guiding principle, independent oversight. As I explained above, the auction has been designed by and is expected to be managed by Dr. LaCasse of NERA, an independent third party. The Auction Manager will have no financial interest in the bidders and will not be paid based on the outcome of the auction. The auction manager will ensure that the guidelines and rules of the auction are followed in an unbiased manner. By controlling the flow of information from potential bidders to Ameren, the Auction Manager can and will deny Ameren access to any information that might give an unfair advantage to its affiliates, thereby preserving the integrity and fairness of the auction process. In addition, the Commission will retain, with expenses paid through the auction process, an independent Auction Monitor to monitor the auction under Commission oversight. This Auction Monitor will then report to the Commission to certify that the auction process has been followed or notify the Commission of any observed irregularities.

Q. Has the FERC approved affiliate PPAs that resulted from competitive solicitations similar to that being proposed by Ameren?

A. Yes. As I explained above, the proposed competitive solicitation is modeled closely on the auction that New Jersey's utilities have used over the past several years to procure basic generation service ("BGS"). Utility affiliates have been among the winning bidders in the last two BGS auctions. In an order issued January 30, 2003, FERC approved an affiliate power sale between Consolidated Edison Energy and Rockland Electric Company made pursuant to New Jersey's

BGS auction, finding that "*[t]he BGS competitive bid process described by Applicants alleviates the Commission's concerns regarding affiliate abuse.*"[38]

In 2004 FERC similarly approved Allegheny Energy Supply Company's request to sell power to an affiliated utility company, Potomac Edison. This sale was made pursuant to the competitive procurement of standard offer service in Maryland.[39] Maryland's competitive procurement process was very similar to the auction used in New Jersey (and that proposed now by us), in that bidders competed for a standardized, pre-specified product—a slice of a utility's retail load—via an open, transparent process that is administered by an independent third party under close supervision of the state regulatory commission. The Maryland process also had many of the same attributes of Ameren's proposed process, such as posting all information on a website and pre-qualifying bidders using publicly available criteria. In addition, winning bids were selected solely on price alone and based on fully pre-specified selection criteria. As a result of these and other features, FERC concluded that the Maryland commission competitive bid process satisfied its concerns regarding affiliate abuse and, more particular, satisfied FERC's four principles for competitive solicitations.[40]

Q. Has the FERC disapproved any affiliate sales made pursuant to a state-supervised competitive procurement for generation service?

A. I am not aware of any instance of FERC rejecting an affiliate power sale resulting from a fully pre-specified, independently managed competitive procurement for

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38 Consolidated Edison Energy, Inc., 102 FERC ¶ 61,097 (2003) (emphasis added).

39 Allegheny Energy Supply Co., LLC, 108 FERC ¶ 61,082 (2004) (Allegheny).

40 Allegheny at P 21.

restructured utilities' regulated service obligations. However, an affiliate agreement from one such procurement effort was recently set for hearing by FERC. The transaction involves a power sale from Conectiv Energy Supply Inc. ("CESI") to its utility affiliate, Delmarva Power & Light Company ("Delmarva"), to supply Delmarva with full requirements service to fulfill their retail load obligation in Virginia.[41] Delmarva held a competitive solicitation to procure generation service for its standard offer service customers and chose CESI. Delmarva's competitive solicitation was modeled after that used in Maryland but with one notable difference: the auction was administered by Delmarva rather than an independent third party. FERC found Delmarva's RFP did not meet the oversight principle announced in Allegheny and, for that reason, ordered that the contract be examined in a hearing.[42]

Our proposal does not suffer from the same deficiency because here the auction has been designed and will be administered by an independent Auction Manager. We will neither run the auction nor determine the winning suppliers. In addition, the auction will be conducted under the supervision of the Staff and an independent Auction Monitor. Thus, our proposal will clearly and fully meet the oversight principle and the other requirements set forth by FERC. We have every confidence that any affiliate supply contract that may result from the competitive procurement process will be approved by FERC.

Q. Does this conclude your testimony?

A. Yes, it does.

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41 Conectiv Energy Supply, Inc., 109 FERC ¶ 61,385 (2004).

42 Id., P 18.